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ROUTING AND TRANSMITTAL SLIP

Date: 22 July 1987

TO: (Name, office symbol, room number, building, Agency/Post)	Initials	Date
1. Executive Registry		JUL 1987
2. D/DCI-DDCI Exec Staff		27 JUL 1987
3.		
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5.		

Action	File	Note and Return
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REMARKS

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FROM: (Name, org. symbol, Agency/Post)	Room No.—Bldg.
Deane Hoffmann NIO/Economics	7E48 HQS
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OPTIONAL FORM
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☆ GPO: 1983 O - 381-529 (232)

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The Director of Central Intelligence

Washington, D.C. 20505

National Intelligence Council

NIC 03028-87
21 July 1987

MEMORANDUM FOR THE RECORD

SUBJECT: EPC Meeting 15 July on Natural Gas Exports, Petition on Tungsten, and Telecommunications

1. The EPC agreed unanimously to recommend a Presidential finding allowing exports of natural gas from Alaska after consultations with the Canadians. A decision would not be made by the President until after the end of the U.S.-Canada free trade discussions set to be concluded 4 October. I mentioned that should energy prices rise sufficiently to make liquefied exports feasible, Alaskan gas would be an attractive alternative to the Japan-Soviet Sakhalin venture. I gave Allan Wallis and Steve Danzansky background papers from OGI on the status of Alaskan gas proposals.

2. The EPC agreed unanimously to seek a voluntary quota for exports of tungsten from Third World countries.

3. The EPC decided to have the TPRG look into the possibility of a government-initiated 301 trade action against countries which do not allow access to US telecommunications equipment. At issue is an expected ruling by Judge Green (the one responsible for your expanded phone bill) allowing Bell companies to manufacture network equipment, likely in conjunction with foreign firms. No action will be taken until after the Judge's ruling in September.

Deane E. Hoffmann

Deane E. Hoffmann

Attachment:
Agenda with Background Material

cc: C/NIC (w/o att)
D/DCI-DDCI Exec Staff (w/att)
NIO/EUR (w/o att)
NIO/OEA (w/o att)
D/EURA (w/o att)
D/OEA (w/o att)
D/OGI (w/att)

CL BY SIGNER
DECL OADR

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Executive Registry
87-2690X

THE WHITE HOUSE
WASHINGTON

CABINET AFFAIRS STAFFING MEMORANDUM

Date: July 17, 1987 **Number:** 490,672 **Due By:**

Subject: Economic Policy Council Meeting -- July 21, 1987 -- 11:00 a.m.

	Action	FYI
ALL CABINET MEMBERS	☐	☐
Vice President	☑	☐
State	☑	☐
Treasury	☑	☐
Defense	☑	☐
Justice	☑	☐
Interior	☐	☐
Agriculture	☑	☐
Commerce	☑	☐
Labor	☑	☐
HHS	☐	☐
HUD	☐	☐
Transportation	☑	☐
Energy	☑	☐
Education	☐	☐
Chief of Staff	☑	☐
OMB	☑	☐
UN	☐	☐
USTR	☑	☐
CIA	☑	☐
EPA	☐	☐
GSA	☐	☐
NASA	☐	☐
OPM	☐	☐
SBA	☐	☐
VA	☐	☐

	Action	FYI
CEA	☑	☐
CEQ	☐	☐
OSTP	☐	☐
Carlucci	☑	☐
Cribb	☑	☐
Bauer	☑	☐
Dawson *(For WH Staffing)*	☑	☐
Executive Secretary for:		
DPC	☐	☑
EPC	☑	☐

REMARKS: The EPC will meet on Tuesday, July 21, 1987 at 11:00 a.m. in the Roosevelt Room. The agenda and paper are attached for your review.

RETURN TO:

☑ Nancy J. Risque
Cabinet Secretary
456-2823
(Ground Floor, West Wing)

☐ Associate Director
Office of Cabinet Affairs
456-2800
(Room 235, OEOB)

DCI
EXEC
REG

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THE WHITE HOUSE

WASHINGTON

July 17, 1987

MEMORANDUM FOR THE ECONOMIC POLICY COUNCIL

FROM: EUGENE J. McALLISTER EM

SUBJECT: Agenda and Paper for the July 21 Meeting

The agenda and paper for the July 21 meeting of the Economic Policy Council are attached. The meeting is scheduled for 11:00 a.m. in the Roosevelt Room.

The first agenda item will be a discussion of a possible Presidential finding for the export of North Slope natural gas. A paper outlining the issue, and its ramifications, is attached.

The second agenda item will be a discussion of the pending Section 406 petition on tungsten. The President must decide by August 5 whether to grant relief from import competition to the tungsten industry, and if so, what form the relief should take. A memorandum from the TPRG is attached.

The final agenda item will be a report from the Working Group on Telecommunications. The Working Group is forwarding for the Council's consideration an option linking further telecommunications deregulation with increased access to foreign markets. A paper prepared by the Working Group is attached.

CONFIDENTIAL ATTACHMENT

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ECONOMIC POLICY COUNCIL

July 21, 1987
11:00 a.m.
Roosevelt Room

AGENDA

1. Natural Gas Exports
2. Section 406: Tungsten
3. Telecommunications

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July 16, 1987

DRAFT

MEMORANDUM

FOR: THE ECONOMIC POLICY COUNCIL

ISSUE: Should the President issue a finding which would permit the export of North Slope Alaskan natural gas.

SUMMARY

Section 12 of the Alaska Natural Gas Transportation Act (ANGTA) provides that before North Slope Alaskan natural gas can be exported to nations other than Canada or Mexico, the President must find that such exports will not diminish the total quantity or quality nor increase the total price of energy available to the United States.

The 1983 Reagan-Nakasone Joint Policy Statement encouraged a pre-feasibility study by Japan and U.S. firms on the joint development of North Slope gas. The pre-feasibility study has been completed. The Trans-Alaska Gas System (TAGS), a private sector project based on that pre-feasibility study, is now being proposed to export North Slope gas to Japan, Taiwan and Korea. The TAGS sponsor is requesting a Presidential finding.

An analysis of world oil and gas markets shows that the export of Alaskan North Slope gas would not diminish the quantity or quality nor increase the price of energy available to the United States primarily because adequate supplies of natural gas are potentially available in the lower 48 states, Canada, and Mexico at a lower delivered cost.

Issuance of a Presidential finding is consistent with the Administration's policy of removing regulatory impediments to allow the full utilization of our domestic energy resources.

A finding might hamper current efforts to negotiate a U.S.-Canadian free trade agreement and might invite a legislative override by members of Congress who oppose exporting U.S. energy resources. A finding would also generate opposition and litigation from sponsors of the Alaska Natural Gas Transportation System (ANGTS), a competing pipeline proposal, dormant since 1982, designed to bring North Slope and Canadian gas to the lower 48 states through an overland pipeline in Alaska and Canada.

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BACKGROUND

Since the initial discovery in 1968 of large natural gas reserves in the Prudhoe Bay region of Alaska's North Slope, numerous proposals have been made to develop those reserves and transport them to markets.

In 1976, Congress passed the ANGTA authorizing the President to select from among competing proposals that pipeline system which would transport North Slope gas to the lower 48 states and become the ANGTS.

A U.S. - Canada agreement on principles relating to the transportation of North Slope gas was signed in 1977.

President Carter selected the pipeline project now known as ANGTS, consisting of an overland pipeline from Prudhoe Bay through Fairbanks and south through Canada, splitting into eastern and western legs to serve the Lower-48. Construction of the second leg was completed in 1982 and Canadian gas is now flowing through both legs to the U.S.

Approval for the "prebuild" portion of ANGTS was a matter of intense political controversy in Canada during the late 1970s. However, the Federal Energy Regulatory Commission (FERC) provided special regulatory treatment to the "prebuild" which ensured the recovery of "prebuild" costs. The FERC has also exempted the "prebuild" from certain regulations that might have jeopardized recovery of "prebuild" costs.

In 1981, President Reagan sent to Congress a proposal to waive certain laws (the "waiver package") to allow gas producers to participate in the project and to facilitate private sector financing. The U.S. House of Representatives and the U.S. Senate approved the waivers of law requested by the President.

Further work on the ANGTS project was suspended by the project sponsors in 1982 because the high cost of completing the project to carry North Slope gas would make the gas unmarketable. The project sponsors argue that ANGTS will become economical in the future, and that construction on the uncompleted portion will resume at that time.

The ANGTS sponsors have incurred substantial expenses in engineering and other pre-construction project costs that cannot be recovered unless the remaining segment of ANGTS is completed. Although completion of ANGTS is uncertain, the opportunity to recover sunk costs on the remaining segment is foreclosed if a more economic project to market North Slope gas is implemented.

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In November, 1983, the President and Prime Minister Nakasone issued a Joint Policy Statement on Japan-U.S. Energy Cooperation. With respect to natural gas, the Statement provided that

> The U.S. and Japan will encourage private industry in both countries to undertake now the pre-feasibility or feasibility studies necessary to determine the extent to which Alaskan natural gas can be jointly developed by U.S. and Japanese interests.

Subsequently, a joint pre-feasibility study was undertaken by ARCO, Japan, and Yukon Pacific for an Alaska Asian Gas System (AAGS) to export North Slope natural gas to Japan. The study assumed an 800 mile pipeline to transport the gas to a port facility where it would be liquefied and shipped via tanker to buyers. The AAGS pre-feasibility study was completed June 1, 1987.

Yukon Pacific Corporation was formed in 1983 to finance and build the TAGS project. (Yukon Pacific does not own North Slope Alaskan gas.)

The TAGS project consists of the 800 mile pipeline and liquefaction facilities examined in the AAGS study project. TAGS will require numerous permits and authorizations at the Federal level, including a Presidential finding under section 12 of ANGTA. The relevant portion of section 12 provides that

> ...before any Alaska natural gas in excess of 1,000 Mcf per day may be exported to any nation other than Canada or Mexico, the President must make and publish an express finding that such exports will not diminish the total quantity or quality nor increase the total price of energy available to the United States.

Yukon Pacific estimates the TAGS project (pipeline, liquefaction plant and conditioning plant on the North Slope) will cost $8.6 billion. The TAGS sponsors forsee a market of 3 to 3.5 million tons of liquefied natural gas (LNG) demand in Japan by the year 1995. Yukon Pacific states that an additional 3.5 to 4 million tons LNG demand from Korea and Taiwan in the same time frame would be needed to establish the project's economic feasibility.

Yukon Pacific is applying for the necessary U.S. Government authorizations and approvals. In addition to the section 12 finding, these include

- o Export authorization from the DOE's Economic Regulatory Administration under section 3 of the Natural Gas Act;

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- Right-of-way grant from the DOI's Bureau of Land Management under section 28 of Mineral Leasing Act of 1920;
- Export exemption from the Department of Commerce under section 103 of the Energy Policy and Conservation Act;
- Federal Energy Regulatory Commission "place of export" approval under section 3 of the Natural Gas Act; and
- Wetland permit from the U.S. Army Corps of Engineers under section 404 of the Clean Water Act.

The TAGS project appears to pose no unusual substantive problems in securing these necessary approvals, but litigation may be expected.

The only concrete project other than TAGS which proposes to get North Slope gas to a market is the ANGTS project, which would move the gas across Canada and into markets in the U.S. The ANGTS project could not recover construction costs in the current competitive gas market. One impediment to export projects is the requirement for a Presidential finding under section 12 of ANGTA. A generic section 12 finding by the President would open the possibility that North Slope gas can be produced for export, while not foreclosing the possibility of production for domestic consumption.

JUSTIFICATION FOR A PRESIDENTIAL SECTION 12 FINDING

Analysis shows that the President has the flexibility to make a finding which satisfies the three criteria specified in section 12 of ANGTA:

Quantity of energy available to the U.S. If North Slope gas is produced, that gas will increase energy available to the United States. This is true whether the gas is exported or consumed domestically. The production of North Slope gas increases the supplies of gas available worldwide. Since gas is traded in international markets, an increase in the availability of gas anywhere increases the available supply to all importing countries. Assuming no barriers to free trade, the gas will move to its most efficient and economic use. If, for example, North Slope gas were exported to the Pacific Rim, gas from Canada, Mexico, Indonesia and other sources that would otherwise have gone to the Pacific Rim market would become potentially available for transport to the United States.

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In addition the Energy Security study and other analyses show that, even without North Slope gas, adequate gas supplies exist to meet projected U.S. natural gas demand for the forseeable future. These supplies include lower-48 gas production and Canadian gas. If demand were higher than currently projected, additional gas supplies are potentially available from Canada, Mexico and unconventional gas supplies, including deep gas in the lower-48.

Quality of energy available to the U.S. Natural gas is a high quality, uniform product. Unlike crude oil, there is little quality difference among lower-48, North Slope, Canadian, Mexican, or other forms of natural gas. Export or domestic use of North Slope gas would likely have no effect on the quality of energy available in the U.S. Quality of energy can also refer to the security of supply of the energy. Production of North Slope gas increases the world's availability of a secure energy source that will likely displace less secure energy, including oil in the Persian Gulf. By increasing the likelihood of production of North Slope gas, a Presidential finding increases the security of supply of energy to the U.S. and our allies, regardless of whether the gas is exported or consumed in the U.S.

Price of energy available to the U.S. Natural gas and other energy prices in the United States are determined primarily by the world oil price and by the cost of production of domestic energy sources. Future oil prices depend largely on OPEC behavior which depends to a large extent on the market for OPEC crude oil. Lower future oil demand would likely result in a lower future oil price.

A generic or blanket section 12 finding would increase the probability that North Slope gas will get to world gas markets. By increasing world availability of natural gas, which is the closest substitute for crude oil, there will be less demand for crude oil and lower world oil prices. Lower world oil prices will reduce energy prices in the U.S. This likely consequence of producing North Slope natural gas is true, to the same extent, whether or not the North Slope gas is exported to the Pacific Rim or consumed in the U.S.

DISCUSSION

The TAGS project proposal is derived in part from the 1983 U.S. - Japanese Government encouragement of private industry to determine the extent to which Alaskan natural gas can be jointly developed by U.S. and Japanese interests.

TAGS project supporters include Yukon Pacific (the sponsor), and

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the Governor and the entire Congressional delegation of Alaska. Alaska's primary interest is the timely development of North Slope natural gas reserves.

ANGTS project sponsors have stated that approval of the TAGS project would violate U.S. commitments to ANGTS. It has been suggested that North Slope gas reserves are insufficient to support both projects. Proved reserves are believed to be in the range of 26-31 Tcf. Reserves of 31 Tcf could probably support both projects assuming 20 year project lives. Lesser reserves or longer project lives could raise the sufficiency question, but actual North Slope gas resources may exceed the estimated "proved reserves" figure. The U.S. Geological Survey estimated that there is more than 100 Tcf in undiscovered recoverable natural gas in Alaska. This raises the possibility that vast quantities of North Slope gas could remain undeveloped if they are accessible only by the ANGTS project. It is likely that suits will be brought by ANGTS sponsors.

THE CANADIAN GOVERNMENT has expressed concern that the U.S. respect its previous agreements on ANGTS. The "prebuild" portion has been promised special regulatory treatment on the recovery of prebuild costs and is currently being used to transport Canadian gas to the lower 48 states. DOE and others have gone on record that U.S. commitments to ANGTS have been fulfilled, but formal reassurances can be made to Canada that a Presidential finding will not change the minimum revenue guarantees and special regulatory treatment of the "prebuild", even if ANGTS is never completed. Canada desires consultations before any authorizations are granted that would affect North Slope gas.

THE JAPANESE GOVERNMENT, in a press statement accompanying the release of the pre-feasibility study, indicated they are more interested in importing Alaskan oil, but they have not rejected the possibility of importing Alaskan LNG. However, it is up to the U.S. private sector to find additional demand outside Japan to support the project as originally conceived or to develop an alternative project configuration. Japan is also continuing discussions with other countries for LNG imports. In June 1987, Japan reopened longstanding discussions with the Soviets on a Sakhalin Island oil and gas project. We have repeatedly urged the Japanese not to commit to Sakhalin gas until they have fully evaluated the alternative of supplies from Alaska. The first phase of the TAGS project would be comparable in size to, and thus a possible substitute for, the Sakhalin gas project. Any sign of Administration reluctance to permit North Slope exports could be seized on by the Japanese as a reason for proceeding with the Sakhalin project.

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CONGRESSIONAL CONCERNS. Although the Alaskan Congressional delegation supports the TAGS project, some members of Congress may view the export of North Slope gas unfavorably on the grounds that (1) U.S. consumers may need that gas at some point in the future; (2) we should not be exporting U.S. energy if our domestic needs require the development of the Arctic National Wildlife Refuge (ANWR); and (3) an adverse reaction from Canada could burden our ongoing trade negotiations. Congress may attempt to override the finding as the House sought to do in H.R. 3, which if adopted would override a recent Presidential decision allowing export of Cook Inlet oil.

The following considerations also bear on a Presidential finding:

- The U.S. Government has committed itself to the expeditious completion of the ANGTS project (by facilitating private sector initiatives) and to the economic viability of the "prebuild". These commitments do not exclude the eventual development of North Slope gas via an alternative project. While it is arguable whether the U.S. has under ANGTA an implementing agreement with any legal obligation to consult, given our 10 years of close cooperation on the issue, consultation prior to a U.S. decision potentially affecting ANGTS is essential. Failure to consult in advance would impact adversely other important aspects of U.S.-Canadian relations, particularly the FTA negotiations.

- The State Department had made an offer of consultation with Canada on this issue, but received no response. The offer was renewed on July 15 by the Departments of State and Energy in a meeting with Mitchell Sharp. The EPC should consider the issues and options raised in this memorandum but should await the conclusions of consultations with Canada before proceeding with a finding. These consultations, however, should not become a basis for delaying the project.

- While many considerations bear on the successful negotiation of an export arrangement, a section 12 finding would facilitate that process. Natural gas exports to Japan, Korea, and Taiwan would ultimately have a beneficial effect on the U.S. balance of trade with Pacific Rim countries.

- A section 12 finding would be a tangible action to show our continuing commitment to the gas export issue. Such action would also be consistent with current legislative efforts to remove regulatory impediments and trade barriers, and would require no separate legislative effort.

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THE ISSUE

SHOULD A PRESIDENTIAL FINDING TO REMOVE AN IMPEDIMENT TO THE EXPORT OF NORTH SLOPE ALASKAN NATURAL GAS BE MADE NOW?

Pro

- o It is argued that failure to act now would effectively kill the TAGS project and could discourage new private sector initiatives to develop North Slope natural gas resources.

- o Delaying the decision may foreclose the Japanese market if they seek supplies from the Soviets and elsewhere. The AAGS pre-feasibility study identifies a narrow window of opportunity for serving the Japanese market in 1998. The TAGS sponsors estimate that construction will require 11 years and must commence quickly.

- o Failure to issue a section 12 Presidential finding could be viewed as a departure from Administration policies to remove regulatory impediments to private sector projects.

- o A section 12 finding will remove a high-level, visible government impediment to allowing the marketplace to determine the most efficient development and use of North Slope gas.

- o A section 12 finding will facilitate negotiation and execution of arrangements concerning North Slope gas with producers, potential customers, and financial institutions.

- o A section 12 finding will expand opportunities for private parties to secure significant employment and other economic benefits, especially for the State of Alaska, but also for the U.S. generally. Construction of pipeline and facilities will boost the Alaskan and U.S. economies, and royalties and taxes on gas will replace the decreasing revenue which Alaska receives from oil.

- o A section 12 finding will encourage development of an important gas supply which may otherwise remain in the ground. It may stimulate additional exploration for and development of gas supplies on the North Slope.

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- A section 12 finding could encourage development of Canadian gas resources in the MacKenzie Delta and elsewhere if North Slope gas is exported rather than shipped to the lower 48 states. Exporting North Slope gas would create a larger potential market for Canadian gas in the U.S. Canadian gas supplies that are closer to the lower 48 states than the North Slope can be delivered at lower cost to U.S. consumers.

Con

- Canada may regard a section 12 finding as a breach of previous U.S. commitments, even if such a finding is not the reason for non-completion of ANGTS. This could make ANGTS an issue in ongoing free trade negotiations between the U.S. and Canada.
- The North Slope gas may be viewed by some as a "strategic gas reserve" -- in effect, a "bank" to meet future domestic needs.
- A section 12 finding may increase concerns of environmentalists regarding economic/energy development of Alaska in general, and of ANWR in particular.
- By not making a section 12 finding, it may be possible to avoid concerns raised by Canada in trade negotiations and to avert sensitivity to the development of ANWR. Permitting exports now may trigger increased Congressional efforts to restrict energy exports, e.g., in the current trade bill.

DECISION

_____ Proceed with a Presidential finding after consultations with Canada.

_____ Do not proceed with a Presidential finding.

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DEPUTY UNITED STATES TRADE REPRESENTATIVE
EXECUTIVE OFFICE OF THE PRESIDENT
WASHINGTON, D.C. 20506
202-395-5114

July 14, 1987

MEMORANDUM FOR THE ECONOMIC POLICY COUNCIL

FROM: THE TRADE POLICY REVIEW GROUP

SUBJECT: SECTION 406 TUNGSTEN PETITION

ISSUE

The President must decide by August 5 whether to grant relief from import competition to the tungsten industry under Section 406 of the Trade Act of 1974, and if so, what form the relief should take.

BACKGROUND

On March 5, 1987, at the petition of the Refractory Metals Association, the U.S. Trade Representative requested that the USITC, pursuant to 406(a)(1) of the Trade Act of 1974, conduct an investigation to determine whether Chinese exports of APT and tungstic acid were disrupting the U.S. industry. On June 5, 1987, the USITC by unanimous vote determined that, with respect to imports of ammonium paratungstate (APT) and tungstic acid, market disruption exists. Three Commissioners recommended a quota restricting the combined volume of imports of APT and tungstic acid for five years to the larger of 1.116 million pounds of tungsten content per year or 7.5 percent of U.S. consumption. One Commissioner recommended a market share quota, for five years, of 17.2 percent of U.S. consumption. One Commissioner recommended a five-year quota of 2.459 million pounds of tungsten content per year.

During the 1982-1986 period (unless otherwise indicated):

o U.S. consumption increased from 12,947 to 14,275 thousand pounds of tungsten content, but peaked at 16,180 thousand pounds in 1984.

o production of APT increased from 10,833 to 12,355 thousand pounds, but peaked at 19,418 thousand pounds in 1984;

o capacity utilization was at a low of 42.8 percent in 1982, reached a high of 77.4 percent in 1984, then dropped to 45.6 percent in 1986;

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- o employment dropped from 195 in 1982 to 108 in April 1987, with the sharpest decline (30 percent) in 1984-1986;

- o on a volume basis, total imports of APT rose from 1,673 to 2,548 thousand pounds tungsten content; imports from China rose from 941 thousand pounds in 1982 to 2.5 million pounds in 1986 (equivalent to 85% of total imports) and;

- o on a value basis, China's share of U.S. domestic consumption rose from 9.6 percent to 16.1 percent (and 28.6 percent in the first quarter of 1987).

The U.S. industry faces a number of difficulties in addition to those posed by import competition. Tungsten products have encountered increased competition from substitutes. In addition, the oil well drilling and mining industries, major end-users of tungsten, have been adversely affected by cyclical demand factors. These factors will play a substantial role in the industry's recovery prospects. It is possible that relief granted could be circumvented through trans-shipments through third countries, fraudulent activities, the export of further downstream products, or the export of tungstic oxides, products almost identical to APT.

Tungsten, a material used in the carbide cutting tool, aerospace, and defense industries, is stockpiled by the U.S. Government through the National Defense stockpile under the Federal Emergency Management Agency (FEMA). In FEMA's FY 88-89 plan for operation of the stockpile, there is a provision that has the potential to nullify any import relief granted. If the President decides to grant relief, FEMA should be directed to review its FY 88-89 plan for tungsten products.

OPTIONS

There was consensus in the Trade Policy Review Group that some form of relief should be provided. The TPRG has developed three basic relief options:

OPTION 1: NEGOTIATE A FOUR-YEAR ORDERLY MARKETING AGREEMENT

- President would direct the USTR to negotiate within 60 days.
- President would announce that, if negotiations fail, a unilateral quota (unspecified) would be imposed, retroactive to the date of his decision to impose relief.
- Treatment of circumvention problems through monitoring would be negotiable.
- OMAs would be degressive subject to annual review.

ADVANTAGES

- o Foreign policy benefit: China will be able to agree to a level of restraint rather than the having the United

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States impose one unilaterally.

- o Could be more effective than a quota in dealing with circumvention issues, since export licensing and exchange of data would be part of an OMA.
- o Legally enforceable by U.S. Customs.
- o Among options presented in this paper, this seems most favored by industry. Chinese also have expressed willingness to negotiate an OMA.
- o Inclusion of circumvention provisions would make clear to the PRC that circumvention is an issue.
- o Threat of imposition of a unilateral quota would provide a strong incentive to the PRC to negotiate.

DISADVANTAGES

- o National economic cost of OMA higher than a tariff or an auctioned quota because Chinese capture scarcity rents.
- o Can only cover products in the petition, unless a monitoring system for higher value products is agreed to.
- o Chinese would probably insist on higher levels of restraint as a *quid pro quo* for accepting monitoring of higher value products.

OPTION 2: IMPOSE A FOUR-YEAR, DEGRESSIVE TARIFF OF 12 PERCENT IN YEAR ONE, REDUCED BY 3 PERCENTAGE POINTS PER ANNUM.

Advantages

- o Additional tariff revenues would offset some of the cost of protection.
- o The amount of protection is visible.

Disadvantages

- o Given the non-market pricing policies of the PRC, it is impossible to determine how much of the tariff the Chinese would absorb and therefore the effect of a tariff on economic indicators.
- o Effects of a tariff on domestic output would be less predictable than those of quantitative restrictions.

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- The high rate of protection in the permanent tariff (10 percent) has not prevented increases in imports from China.
- No USITC Commissioner recommended tariffs.
- The Chinese prefer negotiated quantitative restrictions, if relief is necessary. The Chinese have made it known that in the face of unilaterally imposed relief, China will seek compensation and will consider other options it has regarding tungsten exports.

OPTION 3: FOUR-YEAR, DEGRESSIVE QUOTA TO BE DISTRIBUTED THROUGH AN AUCTION SYSTEM AND INCREASED TEN PERCENT PER YEAR, BEGINNING WITH 1,728 THOUSAND POUNDS CONTENT IN YEAR ONE (equivalent to average annual imports during the 1982-1986 period and is somewhat less than the average of the different quotas recommended by the USITC Commissioners).

ADVANTAGES

- Level of imports, quantity of domestic sales and employment effect would be more predictable than under tariffs.
- Under the auction system, quota rents would accrue to the United States.
- Could mollify Congressional supporters of mandatory auctioning.
- Chinese government has indicated that, if relief is necessary, it would prefer quantitative restrictions to a tariff.

DISADVANTAGES

- Consumer costs would rise if market demand grows.
- Quota relief lacks the transparency of tariff relief, except if quota rents are auctioned.
- Revenue potential uncertain, costs could possibly exceed revenues.
- China may not be willing to see quota rents accrue to U.S. government; may not be willing to have its exports (and no other countries') used as a trial for auctioning.
- As with tariffs, unilaterally imposed relief may result

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in China seeking compensation and considering other options it has regarding tungsten exports.

- Congressional supporters of quota auctioning might view the level of imports as too small to provide a true test of the mechanism.

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Communications Equipment Trade

Discussion and Options Paper

Issue

Should we adopt an integrated trade policy to open overseas communications equipment markets, given possible AT&T antitrust consent decree changes allowing local Bell telephone companies to manufacture network equipment?

Introduction

o **Growing Trade Deficit**. Our communications trade position has deteriorated over the past four years from a $580 million surplus to more than a $1.7 billion deficit. Network equipment imports alone totaled $850 million in 1986 -- $282 million from Japan, $268 million from Canada, and $88 million from the European Economic Community (EEC).

o **Unilateral U.S. Market Opening**. The Bell System breakup opened our market, but Canada, Japan, and the EEC kept theirs closed. Communications equipment markets abroad are controlled by foreign governments and are not competitive now. A major U.S. effort has resorted in small to moderate access in Japan and the U.K. Foreign government-sanctioned barriers to U.S. exports, the absence of free market conditions internationally, and the dollar's rise, caused current trade problems in this key high-tech sector Congress values highly.

o **Prospect for Further U.S. Concessions**. Justice in February recommended changing the AT&T consent decree to let Bell companies manufacture. Such manufacturing would benefit U.S. trade, innovation and competitiveness in many instances. Serious concerns arise, however, regarding one class of equipment -- network products. Such products probably would be made by Bell companies in joint venture, mostly with foreign-based firms. Partnerships would boost foreign access to U.S. markets and expand the protected sales base available to foreign firms -- they would keep their own home markets plus gain the 6-10% of the world phone equipment market each Bell company represents. This would exacerbate U.S. trade problems unless offsetting market access is obtained overseas.

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o Cross-subsidy concerns. Bell company manufacturing of network products creates some risk that regulated services will subsidize equipment operations. This could affect rates and competition, though safeguards might help.

o Likely Congressional Actions. Pending trade bills have undesirable sectoral reciprocity provisions. Adopting an integrated Administration strategy to open foreign communications equipment markets might help when we work with House-Senate conferees to get a less objectionable bill.

o Likely Judicial Action. Judge Greene is likely to rule on Justice's recommendations early this fall. There is no consensus how he will act.

Elements of an Integrated Strategy

A Commerce-chaired Working Group identified these steps as possible elements of an integrated strategy on communications trade:

(1) Mobilize More High-Level Political Effort. Make greater use of Cabinet officers' prestige and persuasive powers, with the President issuing a policy statement and including the topic in speeches.

Pros

-- Shows Congress and trading partners Administration values sector highly.

-- Raises stakes in market access talks, increasing chance for success.

Cons

-- Could absorb political capital better spent on other issues.

-- May involve leadership in disputes better handled by staff experts.

(2) Sponsor "Market Access-Conditioned Manufacturing" Legislation. Propose a bill: (a) permitting Bell companies to manufacture any products (subject to adequate regulatory safeguards against anticompetitive cross-subsidies); (b) but suspending this authority with respect to network equipment; (c) until the Executive certifies progress has been made to open overseas

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communications markets, and eliminate foreign indigenous manufacturing requirements.

Pros

-- Offers a "carrot" to European manufacturers, and shows U.S. market access through joint ventures depends on giving up home market protection.

-- Allows Bell companies to manufacture most products now, yielding trade, competitiveness, and innovation benefits, with a chance to make network products later.

-- Barring all manufacturing of network products now prevents a unilateral trade concession in key sector and avoids international investment policy problems. Eliminating foreign indigenous manufacturing demands would elicit labor support.

-- Shows trading partners Administration won't concede more U.S. market opening without reciprocation, especially in field where foreign companies active here enjoy the fruits of a home market monopoly.

Cons

-- Suspending joint ventures may be too little leverage where foreign-based firms already supply Bell companies.

-- Industry support is uncertain, so Administration would have to bear significant legislative burden.

-- Seems discriminatory to deny Bell companies opportunities other U.S. firms are exploiting.

-- Could be an undesirable precedent for sectoral trade solutions.

(3) Announce Serious Consideration of Communications Tariff Unbinding. International commitments "bind" U.S. communications equipment tariffs to current levels (4 to 8%). Tariff unbinding is internationally regarded as a serious trade strategy step.

Pros

-- Talk of unbinding sends clear signal trading partners can't ignore.

-- Would demonstrate the United States takes persistent overseas barriers to our communications exports very seriously.

-- Neither requires congressional sanction, nor conflicts with Justice recommendations.

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Cons

-- Maintaining credibility requires willingness to unbind, and invites retaliation. Could undercut efforts under article 28 of the General Agreement on Tariffs and Trade (GATT) to get EEC to rebind tariffs.

-- Unbinding could mean compensating trading partners by as much as $850 million, coming from special sectors (e.g., textiles, steel).

-- Tariff unbinding nuances might be lost on Congress, unless carefully explained as part of an overall Administration strategy.

(4) Add Communications Equipment Trade to "Early Harvest." In conjunction with the GATT Uruguay Round, the United States has indicated it wants early progress in several areas -- the "Early Harvest." Would specify communications equipment as part of what we want from Early Harvest and thus elevate the issue internationally.

Pros

-- Shows seriousness, if accompanied by other actions.

-- Consistent with Administration's policy to resolve trade problems multilaterally.

Cons

-- Congress doesn't take Uruguay Round as seriously as trade community.

-- There may be no Early Harvest.

Option 1: Comprehensive Strategy

A comprehensive strategy would combine all elements above, namely: (a) more high-level political effort; (b) market-access conditioned legislation; (c) announced consideration of tariff unbinding; and (d) adding communications equipment to "Early Harvest."

Pros

-- Shows Congress and trading partners the Administration has a comprehensive strategy that takes into account the fact ours now is the only open market for communications products.

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-- Communications network equipment manufacturing is a critical area with potential positive externalities for the domestic economy, plus technical spin-offs.

-- Package approach heightens chances for market openings that could help in dealing with trade legislation.

<u>Cons</u>

-- "Full court press" could trigger countervailing EEC action, placing at risk the 1986 U.S. total communications equipment surplus there of $320 million.

-- Such steps might be seen as retreating from "free trade" and adopting of a sectoral reciprocity approach unless lack of free market abroad is clearly explained.

-- Congressional trade bills may be too far gone.

<u>Option 2: Status Quo</u>

The U.S. would continue to pursue bilateral market opening efforts and raise telecommunications-related trade issues in the Uruguay Round.

<u>Pros</u>

-- Avoids sectoral approach that might spread to other trade areas.

-- Does not invite retaliation.

-- Maintains credibility of multilateral approach.

<u>Cons</u>

-- May not accomplish our objectives.

-- Maintains U.S. market opportunity without achieving corresponding access overseas.

-- Will not satisfy Congress.

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